A Value Investor's Case for Twitter
(NASDAQ: TWTR $29.88 per share)

Twitter is the most powerful news and curation tool in the world and is more valuable today to its users than ever before, but you wouldn't know it by looking at its financials or its stock price. Twitter is nearly the same price as its IPO price seven years ago, despite increasing the value of its network exponentially. In the world of politics, journalism, finance, sports and technology, the value of Twitter's network is unparalleled.

If this is true, why is the value of Twitter's network not being reflected in the share price or financials? A historically distracted management, a disappointing advertising technology engine and a baffling strategy that ignores its "power users" has caused Twitter to dramatically under-monetize the value of its network.

However, now there are two new high-profile investors involved: Jesse Cohn from Elliott & Associates, an aggressive activist firm and Egon Durban from the stellar private equity firm Silver Lake. Both have recently joined the board and Twitter management will either have to start executing on its core advertising technology and implementing a new strategy around monetization or they will be replaced. Either way the stock should move dramatically higher.

The core Twitter network gets more valuable to its users every day and with change afoot, the stock should soon start reflecting that value.

I Unabashedly Love Twitter

Let me first admit, that I love Twitter, and I don't use that term lightly. To someone who is curious about many different things, it is an amazing resource. I've been a user since 2007 and am definitely considered a "power user," a person who uses Twitter much more than the average user. It is simply the greatest curation and learning tool I've ever encountered, but don't just listen to me. Listen to one of the most successful venture capitalists of all time, Bill Gurley of Benchmark Capital. Bill said: "Twitter is the most amazing learning network ever built."

I admit that my love of Twitter may be coloring my view of Twitter the stock but let me expand and say that despite my love, I have never once been moved to buy Twitter the stock until now. Despite loving and using the service for 13 years, April 2020 was the first time I ever became a shareholder.

People Who Don't Use Twitter Don't Understand How Amazing It Is

Many people who don't use Twitter, don't understand how amazing Twitter actually is. First, Twitter is the ultimate source for breaking news. Every single journalist and politician of any consequence is on the site. But it is not only the journalists who are on, but other curious and knowledgeable experts in a wide variety of fields around the world. Ask any Twitter aficionado and they will tell you they felt at least one or two weeks ahead of the news in regard to the coronavirus. When news started to break of the virus spreading in China, I was immediately able to follow two or three of the top virologist and epidemiologists in the world as well as news sources in Italy and Asia. And then from there I was following how top Silicon Valley investors and other interested parties were digesting the news. It was clear that the virus was a much bigger deal than people were thinking. I realized that masks were important and that the world was soon to be on lockdown. Forget about the investment implications for a second, I was able to personally prepare my family and friends. And this was in February.

Bill Ackman of Pershing Squared said something similar: "I started using Twitter actually as a newsfeed and found it to be very, very helpful and interesting, almost having the experience of reading the news a couple of days before you read the news in the rest of the media."

The crowdsourcing of information, links, actionable news and analysis are all free and is breathtaking. Take any subject you are interested in and you can have instant analysis and insight and a constant curation of articles on those topics. You always have to worry about false news and the risk of the echo chamber, but you can quickly deduce who is credible and thoughtful and who isn't.

Another example is how I'm currently using Twitter to follow in real time what is going on in the energy sector. Portfolio managers, former traders for energy hedge funds, amateurs and more are providing a real time perspective on what is going in various sectors of the energy market. Consider that I can obtain daily oil tanker rates through Twitter for every class of vessel. I can follow a Norwegian dry bulk shipping analyst and receive his insight and the news stories he finds of interest as well.

And just to show how awesome and random twitter can be, follow this link to learn how fascinating cement actually is:

https://twitter.com/jasoncrawford/status/1184978015983296513

If you are new to Twitter, here are just some of the people I would recommend you follow:

Conor Sen: @conorsen
Gavin Baker: @gavinsbaker
Dan McMurtrie: @supermugatu
Tyler Cowen: @tylercowen
Patrick O'Shaughnessy: @patrick_oshag
Brent Beshore: @brentbeshore
Modest Proposal: @modestproposal1
Plan Maestro: @planmaestro
COValueInvestor: @COValueinvestor
Nick Timiraos: @NickTimiraos
Bill McBride: @calculatedrisk
Morgan Housel: @morganhousel
And you can follow me, Aaron Edelheit: @aaronvalue

Twitter is simply breathtaking in the amount of shared knowledge it offers. Hopefully, you can see why as a curious person, who happens to be an investor and loves researching things, I would love Twitter.

Who Else Uses Twitter?

Everyone knows that Donald Trump (@realDonaldTrump: 80 million followers) loves Twitter and that the ability to communicate directly with people outside of traditional media clearly helped catapult him to the Presidency.

It's not just Donald Trump who uses Twitter, but every known journalist and commentator. Twitter is an indispensable platform to every political actor.

In the business world, Elon Musk (@elonmusk: 34.2 million followers) is so addicted to Twitter and uses it so much that the SEC had to enforce that someone oversee his Tweets before he sends them out and he still can't stop Tweeting. Why? Because the ability to send your message out directly is unparalleled with Twitter.

Within finance, "FinTwit" is especially powerful. Many top investors and money managers use Twitter, including Doubleline's Jeffrey Gundlach (@TruthGundlach), Kynikos Capital's Jim Chanos (@WallStCynic) and top VC Naval Ravikant (@naval) and Bill Ackman of Pershing Squared (@BillAckman).

In Entertainment, Katy Perry (@katyperry) has 108.5 million followers with Taylor Swift (@taylorswift13) next at 86 million followers.

In sports there are athletes like LeBron James (@kingjames) with 46 million users and commentators like Bill Simmons (@Billsimmons) with 6 million followers.

Here is a list of the most influential people on Twitter:

https://www.brandwatch.com/blog/react-50-most-influential-people-on-twitter-2019/

As of their latest quarter, there are 166 million mDAUs (monetizable daily active users) and easily over 300 million total users of Twitter. Inside of these users, there are power users. Note that approximately, 10% of users write 80% of the tweets.

https://www.pewresearch.org/internet/2019/04/24/sizing-up-twitter-users/

And Twitter users tend to be older, wealthier and more educated than the average user of Facebook or other social media sites.

Twitter's User Generated Content (UGC) Network Keeps Increasing in Value

The holy grail in social media is a USER Generated Content (UGC) Network. These are networks where the users provide the content and that is why it is so powerful.

I have already mentioned the power of this network within politics, business and finance, but there are other areas where Twitter is starting to shine.

Academic research fields are starting to pick up on Twitter's research. Here is a study that shows that Twitter adds quite a bit to academic health research:

https://www.ncbi.nlm.nih.gov/pmc/articles/PMC5308155/

And another one that Twitter helps you generate better ideas:
https://www.semanticscholar.org/paper/How-twitter-users-can-generate-better-ideas-Parise-Whelan/c85406418406951a821f33378e7886027cbe8fdd

When you have the world's greatest curation tool and users keep joining and adding more knowledge, this helps grow the value of the network.

Twitter Thrives During Uncertain Times

It is no surprise that ratings of news programming surge around disasters, big events, political movements and other assorted surprises. And Twitter is no different. Note the latest Comscore data for Internet traffic in April:

Netflix: +56%
YouTube: +47%
Twitter: +39%
Facebook sites: +26%
Google: +38%

My Twitter usage, which was already high, is now even higher as I try to follow more people across a range of expertise (I never knew it would be important to follow virologists and epidemiologists).

The more uncertain the future appears, as we continue to realize how little is known about the virus and as political uncertainty escalates, the more you are going to tune into the news to try to figure out what is going to happen. The same thing happens with Twitter. Consider what happened in the first quarter. Subscriber growth surged 24% in Q1 of 2020. And that is despite all of sports stopping, and sports news and analysis a big part of Twitter. When sports return it will be a big boost for Twitter.

A side note: fantasy sports is a big business, DraftKings (DKNG) currently has a similar market cap to Twitter and breaking news is very valuable to fantasy sports.

With an uncertain future, tough economic times, a big upcoming election and the return of sports, the next few quarters should be very strong for Twitter. But that assumes that management distractions won't continue to be a problem.

Management's Distractions

"Twitter is such a mess – it's as if they drove a clown car into a gold mine and fell in," Mark Zuckerberg, CEO and Founder of Facebook, famously told his friends.

Jack Dorsey, the CEO, currently runs two different companies, Twitter and Square (NYSE: SQ). The company has gone through at least six product directors, the CEO door has been a revolving door, with Dorsey executing a coup of another co-founder to return as CEO. And then consider Jack Dorsey last year openly discussed moving to Africa before the COVID crisis.

(Jack Dorsey does seem to be a charitable person and should be commended for his personal giving and his focus on employee and personal well-being.)

That said, with so many distractions it is not a surprise that Twitter has struggled operationally.

Twitter Has Struggled with its Advertising Technology

Twitter has struggled with its core advertising technology. Twitter users in the past regularly made fun of the ads being served to them and how off-target they were. And this is reflected in how much they earn per user.

Investment banks estimate that Twitter earns 33% to 50% less per user than Facebook. This is why Twitter has underperformed financially despite Twitter's average user being wealthier and more educated. Facebook and Google's ad machines and the technology behind them are simply far superior and amazing in their targeted ads. Twitter, not so much.

All of this is a reflection of management turnover, distractions and poor execution.

In Twitter's defense they are updating their ad technology and there appear to be signs of improvement, though the pace is glacial. There is a ton of opportunity here to improve the economics of the ad business.

Under-monetizing Twitter's Value and Allowing Services That Are Free

Another big problem is that Twitter has been competing in the social networking game and has tried to be Facebook, Snapchat and Tiktok in alternative fashions. And what it really needs to be is Twitter. And to be Twitter, it needs to pay attention to how and why its power users use the service. The goal of the company should be to try to grow its power users.

Common refrain from twitter power users is about how management doesn't understand its own users.

One example is that there are "locked accounts" on Twitter, where for a variety of reasons, people do not want the broader public to follow their feed, only ones they invite and approve. In the finance world, there are stock picking and information feeds, where followers are encouraged to go off the site and pay and then they will get an invite to the locked feed. How in the world does this not happen inside Twitter's ecosystem? Twitter is sitting on an incredible opportunity to promote a subscription model and encourage its users to do so, right within Twitter.

Beyond that, I would easily pay hundreds if not thousands of dollars a year for a Twitter Pro account, with extra features, connectivity and other tools, and I know a lot of people who would do the same thing.

Why can't Bloomberg or the Wall Street Journal have a dedicated Twitter account for breaking news? With my Wall Street Journal subscription should be an option to receive a breaking news or special alert Twitter feed. I would imagine all of the news organizations could work with Twitter that could be a win-win for everyone involved.

Consider another opportunity of under-monetization, a Blue Check mark, verified account. There are 355,000 (https://twitter.com/verified?lang=en) verified accounts from Donald Trump to McDonald's Corporation. The number has doubled since 2016 and it has become a critical resource to communicate in real time and directly with customers and followers.

How much do you pay to get verified? Zero. 92,000 companies tweet more than once a day, 42% tweet 1-5 times a day and 19% tweet 6-10 times a day. 58% of top brands have over 100,000 followers and 80% of Twitter users have mentioned a brand. The cost to those brands is nothing. https://www.brandwatch.com/blog/twitter-stats-and-statistics/

Customer service is another example. Many people have taken to Twitter to complain or reach companies directly or get satisfaction after a problem. Many of these exchanges have gone "viral" as companies stepped up to right a wrong or for customers to praise customer service that went above and beyond. A PR dream for the companies. The cost to companies? Zero.

The opportunity in Twitter is to broaden its scope beyond advertising and really embrace how users are already using the service. And this is the reason the stock is so undervalued and why it has attracted activists ready for change.

Elliott and Silver Lake Activists Join the Board and Investors Finally Have a Catalyst

Earlier this year, noted activist investment firm Elliott & Associates acquired 4% of Twitter and demanded change. Specifically, they wanted to nominate four directors and force Jack Dorsey to pick which company he wanted to run, Square or Twitter.

Then Silver Lake, a pre-eminent technology private equity firm wanted to invest. A three-way negotiation started, and it ended with an agreement for Jesse Cohn from Elliott and Egon Durbert from Silver Lake to join the board and a third independent director to be named later. Silver Lake invested $1 billion at a 0.375% 5-year convertible bond that converts at $41.50 per share (39% higher than its current price). And Twitter committed to a $2 billion share buyback.

This recent Vanity Fair article chronicles the meetings between management and the new investors and shows how serious these investors are:

https://www.vanityfair.com/news/2020/04/in-the-coronavirus-era-the-force-is-still-with-jack-dorsey

Please also note that Silver Lake has $40 billion under management and has previously made $5 billion on their sale of Skype to Microsoft and over $10 billion in profits from Dell.

The last part of the activist deal was to agree to "succession planning" by the end of the year. One way or another management is going to step up or step out and Twitter shareholders will benefit.

I also think expense reduction will be a part of a turnaround as well and I believe was a reason for the recent quiet announcement that Twitter employees can permanently work from home. Nothing has been more expensive than San Francisco rent and deluxe office treats, meals and benefits for employees.

One way or another change is coming this year for Twitter.

The Board of Directors is a Powerhouse Right Now

For a company with so many past management struggles, the board is now a powerhouse with the President and COO of Salesforce and now three high level ex-Google execs, a prominent activist and a technology private equity CEO. See here:

https://investor.twitterinc.com/corporate-governance/board-of-directors/default.aspx

The most recent board addition is also very impressive and is exactly what Twitter needs.

Dr. Fei-Fei Li is the inaugural Sequoia Professor in the Computer Science Department at Stanford University, and the Denning Family Co-Director of Stanford's Human-Centered AI Institute (HAI). She served as the Director of Stanford's AI Lab from 2013 to 2018. From January 2017 to September 2018, Dr. Li was Vice President at Google and served as Chief Scientist of AI/ML at Google Cloud. Dr. Li obtained her B.A. degree in physics from Princeton in 1999 with High Honors, and her PhD degree in electrical engineering from California Institute of Technology (Caltech) in 2005. She joined Stanford in 2009 as an assistant professor. Dr. Li is known for her pioneering research work in computer vision and AI, especially her significant contribution to starting the Deep Learning era. She is an elected member of the National Academy of Engineering, which is among the highest professional distinctions accorded to an engineer.

It's not hard to imagine that this board will demand a lot from management and will expect results to improve.

Twitter is a Constant Acquisition Target

At one time or another Disney, Salesforce, Google and Facebook have all looked at acquiring Twitter. And that's who has publicly acknowledged looking at the company.

Consider how Twitter could complement Apple and allow the company to dominate news, and of course don't count out Amazon. This should put a bid under the company's value falling too far, as I'm sure there are other companies out there who could improve the economics of the business.

The Microsoft and LinkedIn Example of How to Monetize Users

Microsoft knows a thing or two about making money. Consider how they paid a 50% premium to the share price to acquire LinkedIn beating out Salesforce, Google and Facebook. And what has happened since?

Revenue has doubled since the deal closed and user growth has increased 50%. This is what happens when you know how to monetize your customer base. It's not hard to imagine another company doing the same thing with Twitter.

https://www.bnnbloomberg.ca/three-years-after-microsoft-acquisition-linkedin-keeps-quietly-climbing-1.1335990

Valuation is Compelling

Twitter is sitting on almost $8 billion in cash and $3.4 billion of debt (mostly convertible debt that is low cost and converts at $41.50, $80.20 and $105.28 per share), that gives the company an enterprise value of $19 billion. Compare that to Facebook's $540 billion enterprise value and you realize that Facebook is twenty times more valuable than Twitter. They are not even in the same ballpark.

The value investor's case for Twitter here is not in valuation based upon them earning $1.3 billion in estimated EBITDA in 2021, but that the company is dramatically under-earning its potential, by having an inferior ad technology and not introducing premium and subscription services.

If just 5% of its 166 million daily active users paid $10 a month (I would happily pay more) for a premium service, that would add $1 billion in revenue, and at 80% gross margins, cash flow would explode higher. Add in paying for verification and you could add another $100 million as well.

Add in closing the ARPU gap with Facebook, and Twitter has the potential to earn $3+ per share in free cash flow in coming years, and this stock would re-rate multiples higher.

Also, Twitter has a federal tax shield of $2.3 billion and $1.3 billion on a state level, so any cash flow they earn will drop right to the bottom line.

Most of the Wall Street Analysts Ignore or Dislike Twitter

Of the 44 analysts who cover Twitter, 30 have “Hold” recommendations, 4 have “Sell” recommendations, and only 10 have “Buy” recommendations. A hold is basically a sell in Wall Street analyst recommendations, so the overwhelming consensus is that you would have to be nuts to invest in the company. Compare that to Facebook with 42 Buy or Outperform recommendations and only 4 holds. Or Snapchat, a company with its own struggles has 24 Buys, 14 Holds and 2 Sells.

Wall Street doesn’t like Twitter, and this sets the stage for a dramatic reversal if analysts start to change their tune.

Risks

I believe the risks are mainly priced into the stock, which include, continued underperformance of the company, no real change in strategy, and no real change in results, which will lead to continued underperformance of the stock. Though with the activists on the board, this underperformance will likely not be tolerated for long.

Summary

I believe that Twitter represents an opportunity in one of the most powerful networks ever built at a relatively low valuation. Management should be able to fix its core advertising technology and move into other monetization models that should radically improve its cash flow. If they do not, I believe management will be changed, or the company will be sold.

The importance and ever-increasing value of Twitter should keep a lid on the downside and if they can turn the corner, the stock could increase multiples of its current share price.

Catalysts

Continued improvement of ad tech
Monetization announcements around subscriptions or other monetization experiments
Return of sports
Change in management
Improving strategy focus